

Report of the auditor-general to the Eastern Cape provincial legislature and the council on Mbhashe Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of Mbhashe Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

6. Irregular expenditure of R117,8 million (2014: R114,6 million) is disclosed in note 29. The municipality's processes for the recording and recognition of irregular expenditure were insufficient as amounts were not recorded. Consequently, irregular expenditure is understated by R13,3 million (2014: R10,9 million). Due to the lack of systems, it was impracticable to determine the full extent of the understatement of irregular expenditure. Furthermore sufficient appropriate audit evidence could not be obtained as supporting documentation was not submitted for audit purposes. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustment to irregular expenditure as disclosed in note 29 was necessary.

Qualified opinion

7. In my opinion, except for the possible effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of Mbhashe Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with the in accordance with SA standards of GRAP and the requirements of the MFMA, and DoRA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material underspending of conditional grant

9. The municipality has materially underspent on the Municipal Infrastructure Grant (MIG). The unspent portion of the conditional grant for the MIG amounts to R16 million as at 30 June 2015 and is disclosed in note 15 to the financial statements.

Material impairments

10. As disclosed in note 5 to the financial statements, impairments of R22,7 million (97%) was provided for in respect of consumer debtors.

Unauthorised expenditure

11. Unauthorised expenditure of R20,5 million as disclosed in note 27 to the financial statements was incurred due to overspending of the budget. No disciplinary action is deemed necessary due to the nature of the expenditure and the amount was subsequently approved.

Restatement of corresponding figures

12. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors only corrected during the year ended 30 June 2015 in the financial statements at, and for the year ended, 30 June 2014.

Additional matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

15. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - KPA 2: Service delivery and Infrastructure services on pages x to x
17. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
18. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected development objectives are as follows:

Service Delivery and Infrastructure Services

Usefulness of reported performance information

21. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 43% of the reported targets were not consistent with those in the approved integrated development plan. This was due to inadequate review processes and systems over the collation and reporting function.
22. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 24% of the targets were not specific.
23. Performance targets should be measurable as required by the FMPPI. We could not measure the required performance for 24% of the targets.

24. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 21% of the indicators were not well defined.
25. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

Reliability of reported performance information

26. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work done as the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matter

27. I draw attention to the following matter.

Achievement of planned targets

28. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development objectives reported in paragraphs 21 to 26 of this report.

Compliance with legislation

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Procurement and Contract Management

30. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
31. Awards were made to providers who are in the service of the municipality and whose directors/ principal shareholders are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).
32. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for councillors issued in terms of the Municipal Systems Act.
33. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).

Consequence Management

34. Unauthorised, Irregular and Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Expenditure Management

35. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
36. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset Management

37. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the MFMA and Municipal investment regulation 3(1)(a).

Annual Financial Statements and Annual Reports

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Human Resource Management

39. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the Municipal Systems Act.
40. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Municipal Regulations on Minimum Competency Levels 14(2)(a).
41. The competencies of the chief financial officer, financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by Municipal Regulations on Minimum Competency Levels 13.
42. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Municipal Regulations on Minimum Competency Levels 14(2)(b).

Revenue Management

43. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of MFMA.
44. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
45. An effective system of internal control for debtors / revenue was not in place, as required by section 64(2)(f) of the MFMA.
46. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Strategic and Performance Management

47. The annual performance report for the year under review did not include:
- the performance of each external services provider,
 - a comparison with the previous financial year and
 - measures taken to improve performance as required by section 46 (1)(a), (b) and (c) of the MSA.
48. Measurable performance targets for the financial year were not set in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
49. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Audit Committee

50. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
51. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
52. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.

Internal control

53. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

54. The audit of the financial statements is reliant on inputs of all departments, and, although top leadership displays a positive attitude towards sound financial administration, the current forward momentum is not sustainable unless the ownership of responsibilities and living financial disciplines is rolled out to all levels of staff in the municipality. An increase in accountability by senior management has been noted in the current year; however there is still a lack of oversight over predetermined objectives.

Financial and performance management

55. The municipality did not have an effective records management system in place to reliably account for the reporting on predetermined objectives. As a result, the municipality still had a challenge in providing documentation to support their reported performance.

56. The municipality's compliance monitoring process has not been effective in the implementation and monitoring of controls to ensure compliance with its laws and regulations is prevented and detected. This contributed to repeat non-compliance findings in the current year.
57. Management utilised the audit process to correct their financial statements which included the correction of material misstatements which, although did not improve the audit outcome, resulted in reduced qualification areas.

Governance

58. There was not always an effective oversight review over financial information, compliance with laws and regulations and reporting on predetermined objectives, as findings in these areas were identified during the year. This is a critical area for the all oversight bodies to address going forward in order to ensure clean administration.

AUDITOR GENERAL

East London

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence